No. 15945

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ALBERT GERSTEN, MYRON P. BECK and ANN H. BECK, MILTON GERSTEN and MARY GERSTEN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF OF PETITIONERS.

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JURISDICTION.

These are appeals from three judgments of the Tax Court of the United States, each entered October 31, 1957. Said judgments were entered in separate proceedings which were consolidated for trial and hearing.

Within ninety days after August 24, 1953, the date of the mailing by the Commissioner of Internal Revenue of separate notices of deficiencies to petitioner, Albert Gersten, to petitioners Myron P. Beck and Ann H. Beck, and to petitioners Milton Gersten and Mary Gersten, respectively, in the petitioners' income taxes, each of the petitioners filed their petitions for redetermination of the respective deficiencies pursuant to Section 272(a) of the Internal Revenue Code of 1939 [R. p. 3]. The Tax Court of the United States has jurisdiction of such actions

under the provisions of Sections 1101 and 272 of the Internal Revenue Code of 1939.

As set forth in the separate petitions for review [R. pp. 98, 100, 102] each of the petitioners are residents of Los Angeles County in the State of California [R. pp. 99, 101, and 103]. Each of the petitioners filed their respective income tax returns for the taxable year 1950 with the District Director of Internal Revenue for the Sixth District of California whose office is located within the Ninth Judicial District wherein each of the petitioners also reside [R. pp. 99, 101, 103]. The United States Court of Appeals for the Ninth Circuit has jurisdiction to review the decision of the Tax Court under the provisions of Section 1141 of the Internal Revenue Code of 1939 and Section 7482 of the Internal Revenue Code of 1954.

STATEMENT OF THE CASE.

ISSUE I.

The Ability or Inability to Ascertain the Value of the Contract Rights Distributed to the Stockholders Upon Dissolution of the Corporations.

Petitioner Ann H. Beck is, and at all times material hereto was, the wife of petitioner Myron P. Beck, and petitioner Mary Gersten is, and at all times material hereto was, the wife of petitioner Milton Gersten. The petitioner wives filed joint returns for the taxable year 1950, here involved, with their respective husbands and are parties hereto solely for that reason. All of the petitioners kept their books and reported their income on a cash basis [F. of F., R. p. 69]. All references herein to petitioners, respecting this issue, will refer to petitioners Albert Gersten, Myron P. Beck and Milton Gersten.

Said petitioners[1] were stockholders of four corporations which were engaged in the business of subdividing tracts of land, constructing houses thereon and selling such houses [F. of F., R. p. 69].

The extension of pipelines for water service was essential to the subdivision of said tracts and the sale of the houses constructed thereon. In order to provide water facilities for the subdivisions here involved, contracts were entered into with the San Gabriel Valley Water Company (sometimes hereinafter referred to as "San Gabriel"), which agreed to extend its water lines into the subdivisions in question, conditioned, however, upon payments by the subdividing corporations of the cost of such extensions [F. of F., R. p. 69].

Under the contracts, San Gabriel was to make payments to the subdividing corporations on the basis of its gross receipts from the sale of water to homes in the particular subdivision. The payments were to terminate in some cases ten years from the date of the contract and in others ten years from the date the lines were completed, or earlier, if the full amount should have been paid prior to the end of the ten-year period. Accordingly, the subdividing corporation might or might not receive payment in full. The corporations did not hold title to the facilities [F. of F., R. p. 70].

The four corporations were all dissolved by December 31, 1950. Substantial amounts of their original payments to San Gabriel remained unpaid at the time of their dissolution, and the right to receive repayments pursuant to such contracts, which were fully transferable,

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[1]Petitioner Milton Gersten was a stockholder of only two of the four corporations involved.

were assigned to petitioners, as stockholders, upon the dissolution of the corporations [F. of F., R. p. 70]. Petitioners did not assign any value to their respective interests in such contracts, in arriving at the gain realized upon liquidation of the corporations. Respondent determined that the rights under each of the contracts did have a fair market value when they were received by the stockholders in liquidation, and accordingly, in his determination of deficiencies herein increased the amount of capital gain realized [F. of F., R. p. 71]. Respondent determined that each of such contracts had a value of 50% of the maximum balance which might, as of the time of dissolution, become payable by San Gabriel [F. of F., R. pp. 73, 75, 77 and 78].

The minimum rate per month for water consumers which was charged by San Gabriel during the periods 1948, 1949 and 1950 was $1.25 [F. of F.; Stip. Par. 75, R. p. 121] but none of the purchasers of any of the residences included in any of the tracts involved were required, by or in connection with the contract of purchase of the residence, to use or purchase water from San Gabriel, in any amount, or for any period, or at all [F. of F.; Stip. Par. 64, R. 120].

In its findings of fact, the Tax Court held, as an ultimate fact, that the contracts each had a fair market value, at the respective dates of dissolution, equal at least to the amounts determined by respondent [F. of F., R. pp. 73, 75, 77 and 79]. This ultimate fact was inferred by the Court, apparently from its finding of the evidentiary fact that similar contracts were bought and sold [F. of F., R. p. 70].

The questions presented on this issue are (i) at the dates of dissolution of the corporations, did the respective

contracts have an ascertainable fair market value, and (ii) even assuming such ascertainable fair market value, were petitioners required to include in their income tax returns for years prior to actual receipt, any amount subsequently paid in respect of such contracts. A negative answer to either of these questions requires a reversal on this issue.

ISSUE II.

Was Petitioner Albert Gersten Entitled to File a Joint Return for the Taxable Year 1950 With His Wife, Bernice Ann Gersten.

On April 3, 1950, Lucille Gersten obtained an interlocutory decree of divorce from petitioner Albert Gersten (herein sometimes called "Albert") in an action filed in the Superior Court of the State of California in and for the County of Los Angeles. On November 2, 1950, Albert obtained a final decree of divorce from Lucille Gersten in the First Civil Court of the State of Chihuahua of the Republic of Mexico, sitting at Juarez. On the same date, immediately following the Mexican decree, he married Bernice Ann Gersten (herein sometimes called "Bernice") in Juarez. The California interlocutory decree was not final on the date of the Mexican divorce and marriage. At all times during the year 1950, Albert and Bernice were residents and domiciliaries of the State of California [F. of F., R. p. 80].

The parties stipulated to, and no dispute exists concerning, the facts found by the Tax Court on this issue. The trial court held that, on the basis of those facts, Albert and Bernice were not legally married during 1950, and that accordingly they could not file a joint income tax return.

The sole question presented by this issue is whether or not petitioner Albert Gersten could file a joint income tax return for the year 1950 with Bernice, pursuant to the provisions of Section 51(b) of the Internal Revenue Code of 1939.

As to Both Issues.

On August 24, 1953, the Commissioner sent to each of the petitioners, by registered mail, a notice of the deficiencies here involved [R. pp. 19, 39 and 55]. Within ninety days thereof, petitioners filed petitions for redetermination of the deficiencies with the Tax Court of the United States [R. pp. 7, 27, and 47] and on April 29, 30 and May 1, 1955, a hearing was had before the said Tax Court [R. p. 123]. On June 28, 1957, the Honorable Bolon B. Turner, Judge, entered the Findings of Fact and Opinion [R. p. 61] wherein it was found and held, as to the issues here involved, as described above.

SPECIFICATION OF ERRORS.

Issue I.

1. The Tax Court erred in determining, as an ultimate fact, that the contract rights received by petitioners from the dissolution of the corporations had an ascertainable, as distinguished from an unascertainable, fair market value.

2. The Tax Court erred in determining, as an evidentiary fact, that there existed a market in which contracts of the kind here involved were regularly traded in or regularly bought and sold. There is no evidence in the record to support or justify such a finding.

3. The Tax Court erred in failing to determine that, because petitioners used the cash receipts method of

accounting, they were not required to report receipts from the contracts here involved prior to the year of actual receipt.

4. The Tax Court erred in determining that there was any deficiency in the income taxes, for the year 1950, of any of the petitioners, by reason of additional capital gains attributable to the receipt, on dissolution of the corporations, of the contract rights.

Issue II.

1. The Tax Court erred in determining that, in 1950, petitioner Albert Gersten, and Bernice Anne Gersten, were not husband and wife, under the laws of the State of California, and accordingly were not entitled to file a joint income tax return for that year.

2. The Tax Court erred in determining that there was a deficiency in petitioner Albert Gersten's income taxes for the year 1950, attributable to the disallowance of his election to file a joint income tax return for 1950 with Bernice Anne Gersten.

SUMMARY OF ARGUMENT.

Issue I.

1. The rights which petitioners received, under the contracts assigned to them on the dissolution of the corporations, were rights, subject to a ceiling amount, to receive payments from San Gabriel measured by a percentage of amounts received by San Gabriel from the sale of water, during a limited period of time, to certain of its customers.

2. Because of future unpredictable conditions respecting the purchase of water by San Gabriel's customers, there is, and at the dates of dissolutions was, no way to

ascertain the fair market value of the rights under the contracts. This principle has been too well established by the Supreme Court of the United States, by this Court as well as several of its sister appellate courts, and by the Tax Court itself, in a number of cases, to permit its rejection here.

3. The fact that (i) the limited time during which the contract rights would continue ranged from approximately seven to nine years, (ii) that some of the payments under the contracts had actually commenced prior to dissolution, (iii) that experts testified that an average of 70% of the maximum receipts from contracts similar in form and nature to those here involved, but with some paying much less than 70%, and some more than that amount, depending upon the particular circumstances of each case, (iv) the existence of six isolated sales out of several hundred similar contracts then existing, made at unknown times, prices or terms, or all of these four facts collectively, creates no certainty and furnishes no reasonable standards from which a fair market value may be reasonably ascertained.

4. In any event, six isolated sales out of several hundred similar contracts in existence do not justify the drawing of an inference either that there existed (i) a market in which such contracts were regularly traded in, or (ii) an ascertainable fair market value. This appellate court is not bound by such erroneous inferences or conclusions.

5. In any event, the well established annual accounting concept for income tax purposes precludes the requirement that taxpayers report receipts from such contracts as income prior to the year of actual receipt.

Issue II.

1. Congress' objective in enacting Section 51(b) of the Internal Revenue Code of 1939 was to give husbands and wives from noncommunity property states income tax benefits equivalent to those from community property states. Accordingly, its concept of "husband and wife" had reference to a marital status or relationship which, under state law, would permit them to file income tax returns on a community property basis if they were residents of community property states.

2. The determination of such a marital status depends upon state law. Under the laws of the state of California, of which petitioner Albert Gersten, and Bernice Ann Gersten, were residents and domiciliaries, a Mexican decree of divorce obtained by Albert, with the aid of Bernice, from his prior wife, and the Mexican marriage, resulted in a status, as between Albert and Bernice, of husband and wife.

3. A contrary status for the purpose of the income tax laws would make the administration thereof impossible in this area. It must be assumed that Congress intended no such difficulties or incongruous result. By executive interpretation, the Commissioner of Internal Revenue, charged with the administration of the income tax statutes, has so assumed, and has conceded for this purpose, a recognition of Mexican divorces and marriages.

4. Accordingly, in view of their status as husband and wife under California law, and under respondent's own general interpretation of the statute involved, the rejection by the Tax Court of the election by Albert and Bernice to file a joint income tax return for the year 1950, was erroneous.

ARGUMENT.

ISSUE I.

A. The Ability or Inability to Ascertain the Value of the Contract Rights Distributed to the Stockholders Upon Dissolution of the Corporations.

1. Introductory.

On the dissolution of the four corporations,[2] the rights to receive payments from San Gabriel were transferred and assigned to the petitioners as stockholders. At that time San Gabriel's obligation as to each contract, was to pay petitioners an amount equal to 33⅓% or 35% of the amounts which San Gabriel received for the use of water from the occupants of the houses in the area covered by the respective contracts. San Gabriel's obligation was limited by the then balance of a maximum amount stated in each contract and was terminated in any event after a date less than ten years from each date of dissolution, whether or not the aggregate of its payments under the contract equaled said maximum.[3] Neither San Gabriel nor the stockholders could compel the owners of the residences in any of the tracts covered by the contracts to occupy said residences or to use or purchase water from San Gabriel in any amount, or for any period, or at all.[4] On the other hand, at the time of dissolution, the houses were occupied and the occupants were purchasing water from San Gabriel so that the stockholders could expect to receive some payments from San Gabriel pursuant to the provisions of the contracts, but with no as-

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[2]Respectively on December 31, 1950, December 28, 1950, November, 8, 1950, and June 22, 1950.

[3]F. of F. Ex. 1 through 7, which formed part of the Stipulation.

[4]F. of F. Stip. Par. 64, R. p. 120.

surance as to what extent, at what rates, or for how long a period of time, since as indicated these factors depended upon activities of and transactions by persons over whom neither San Gabriel nor the stockholders had control.

2. The Contract Rights, in All Material Respects, Are Indistinguishable From the Contracts Involved in Burnet v. Logan[5] and Westover v. Smith.[6] Accordingly, They Must Be Held to Have No Ascertainable Fair Market Value at the Time of Dissolution.

As indicated by the record references, the foregoing facts were not merely proved by petitioners, but were stipulated to by petitioners and respondent and specifically adopted by the Tax Court as a part of its findings of facts. Accordingly, without more, it would seem that the instant case comes squarely within the blanket of and is controlled by the cases of *Burnet v. Logan,* 283 U. S. 404; *Westover v. Smith,* 173 F. 2d 90; *Commissioner v. Carter,* 170 F. 2d 911; and *J. C. Bradford v. Commissioner,* 22 T. C. 1057, at 1070 (1954), which held that contracts of this nature, having the elements of the contracts here involved, have *no ascertainable* fair market value.

That being so, petitioners, under the principles of said cases, were not required to attribute any value to the water contracts in determining their respective gains upon the liquidation of the corporations.

In the *Logan* case, the taxpayer sold shares of stock for a fixed amount plus additional contingent amounts measured by sixty cents per ton of 12% of the ore mined by a subsidiary of the corporation whose shares

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[5]283 U. S. 404.

[6]173 F. 2d 90.

were being sold. The contract did not and could not impose any obligation upon the subsidiary (which was not the purchaser) to mine one or more tons of ore, although the subsidiary was, at the time of the sale, engaged in the business of mining and selling the ore, and, from the opinion in the case, it is apparent that no one contemplated, as a matter of possibility or probability, that it would not continue to do so. The Commissioner, viewing the sale as an entirely closed transaction, sought to value this contingency, or contingent right, and fix a fair market value as of the date of the sale.[7]

The Supreme Court pointed out that, although such a valuation was necessary for estate tax purposes, since such a determination must be made once, in connection with that tax, it was entirely unnecessary to attempt to value, for income tax purposes, a contract which depended upon contingencies over which the seller had no control and in respect of which the buyer was under no legal obligation to perform. In this connection the court stated (at p. 412):

> "Nor does the situation demand that an effort be made to place according to the best available data some approximate value upon the contract for future payments. This probably was necessary in order to assess the mother's estate. As annual payments on account of extracted ore come in they can be readily apportioned first as return of capital and later as profit. The liability for income tax ultimately can be fairly determined without resort to mere estimates, assumptions and speculation."

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[7]In fact, 11/80ths of the total contract in question had been acquired by the taxpayer from her mother's estate, and for estate tax purposes that fraction had been valued at two hundred seventy-seven thousand odd dollars.

In *Westover v. Smith, supra,* the taxpayer was the owner of all of the stock of a corporation engaged in the manufacture and sale of machine tools. After the corporation had sold all of its assets to another in exchange for cash and the right to receive 10% of the gross sales price of machinery to be manufactured pursuant to patents theretofore owned by it, taxpayer liquidated the corporation. The distribution in liquidation netted the taxpayer cash in excess of her basis for her stock and, in addition, the assignment of the contract under which the future contingent payments were to be made. The Court stated (at p. 91) that

> "while the contractual rights she held *had a very substantial value,* there was, owing to future business contingencies, no way of ascertaining its fair market value. Therefore, the taxpayer assigned no value to the contract on liquidation, but reported the later payment as capital gains representing 'an integral part of the liquidation distribution.'" (Emphasis added.)

The government contended that the *Logan* case did not apply because it did not involve a corporate distribution. The Court disagreed on the ground that the profits "arose directly out of the contract" distributed by the corporation, and stated that distributions "are treated in the same manner as sales," going on to state (at p. 92):

> "It is clear that the contract itself was a distribution under section 115(c). Its taxable valuation is its fair market value, according to section 111(b) of the Internal Revenue Code. Although there was no ascertainable fair market value at the time of liquidation, we find nothing in the statute requiring the market value to be measured immediately. In

such a situation *the only practicable and accurate method of measuring the contract's value is through the application of money to such valuation as it is received.*" (Emphasis added.)

In its decision, the Court relied upon *Burnet v. Logan, supra,* which it described as "a case which presents a factual situation almost identical with that of the instant case."[8]

Commissioner v. Carter, supra, also relied squarely upon *Burnet v. Logan.* In that case the contracts involved called for payment of commissions to the liquidating corporation in respect of services which were completely rendered but the payments were entirely contingent upon the happening of events which neither the liquidating corporation nor the recipient stockholder had a legal right to control. Applying the principles of the *Logan* case, the court there held that no value should be placed upon said contingent contract at the time of liquidation, but that after payments upon the contract were received they were required to be taken into income by the stockholder as additional capital gains.

In *Bradford,*[9] the facts on this issue are virtually identical with the facts in the instant case, except that the payments from the utility company there involved related to power lines rather than water pipes. There, taxpayer, in complete redemption of her preferred stock received "the benefits under a contract dated September 2, 1942, between Mobile Homes, Inc.[10] and the Alabama Power

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[8]At page 92.

[9]22 T. C. 1057 (1954).

[10]The subdivider whose preferred stock was being redeemed from taxpayer.

Company. . . . It [the power company] required Mobile Homes, Inc. to advance the money to run the wires into the project. In return, Mobile Homes, Inc., was to receive 20 per cent of the net income that the Alabama Power Company realized upon power sales to the occupants of the houses."[11] The Commissioner contended that in respect of payments made by the power company to taxpayer after the dissolution, that the taxpayer realized ordinary income rather than a capital gain. In rejecting Commissioner's contention, the Tax Court stated (at p. 1072):

> "Ordinarily, if the value of the right received exceeds the cost basis of the stock redeemed, a gain will be realized by the taxpayer when the exchange is made. But in the instant case the Alabama Power Company's contractual right had no ascertainable fair market value when it was received by Eleanor. Under circumstances indistinguishable from those here present, it was held in *Commissioner v. Carter* (C. A. 2), 170 F. 2d 911, affirming 9 T. C. 364, and *Westover v. Smith,* 173 F. 2d 90, that where the contractual right received in exchange for the stock has no ascertainable fair market value, no gain is realized until the payments exceed the cost basis and, thereafter, the payments are taxed as capital gains. The above cases rely primarily upon *Burnet v. Logan,* 283 U. S. 404, which, we agree, is controlling. The fact that the payments are to be received from a third party rather than from the corporation purchasing the stock is immaterial. The fair market value of the contractual right received is equally unascertainable, . . ."

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[11]At page 1065.

The most recent Tax Court decision on the subject appears to be *Lentz v. Commissioner,* 28 T. C. ....., No. 136, decided in September, 1957. In that case, the Tax Court, following *Logan, Smith, Carter* and *Bradford,* held that the right to receive future commissions contingent upon the consummation of mortgage transactions by third parties not legally required to do so, but of a type which immediately prior and subsequent to dissolution were being consummated, had no ascertainable fair market value for the purpose of measuring the gain of the recipient stockholders upon distribution to them in liquidation.

In addition to the *Smith, Carter, Bradford* and *Lentz* decisions, the principles of the *Logan* case have been applied in many decisions, with respect to many types of contingent receipts, including those measured by oil or gas production,[12] profits of a mine or quarry,[13] earnings of a patent,[14] dividends paid by a corporation,[15] brokerage commissions paid by specified customers,[16] and renewal commissions over a stated period of years, and a percentage of the purchaser's net operating profits for five years.[17]

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[12]*Commissioner v. Moore,* 48 F. 2d 526 (C. C. A. 10, 1931); *Commissioner v. Garber,* 50 F. 2d 588 (C. C. A. 9, 1931); *Commissioner v. Edwards Drilling Co.,* 95 F. 2d 719 (C. C. A. 5, 1938); *Kay Kimbell,* 41 B. T. A. 940 (1940); *Rocky Mountain Development Co.,* 38 B. T. A., 1303 (1938); *Hunt Production Co.,* 38 B. T. A. 457 (1938).

[13]*George James Nicholson,* 3 T. C. 596 (1944); G. C. M. 9798, X-2, Cumulative Bulletin 221 (1931).

[14]*Commissioner v. Hopkinson,* 126 F. 2d 406 (C. C. A. 2, 1942); *Cf., United States v. Carruthers,* 219 F. 2d 21 (C. A. 9, 1955).

[15]*Estate of Raymond T. Marshall,* 20 T. C. 137 (1953).

[16]*Cassatt v. Commissioner,* 137 F. 2d 745 (C. C. A. 3, 1943).

[17]*Jones v. Squire,* 56-2 U. S. T. C. Par. 9669 (D. C., Wash.).

The reasoning of the above cases is applicable to the instant case. There is no question that it was contemplated by the corporate taxpayers and by San Gabriel, which was to make these contingent payments, that the contingency would probably arise, although to what extent, at what rate and for what period of time could not be known by either of the contracting parties. But here, as in the *Logan* case, though it was probable that the contingency would arise to some extent, it is entirely unnecessary to concern ourselves with it.

Although it appears that the facts here involved, specifically including the nature and concept of the contingent rights received by the stockholders in respect of the water contracts are indistinguishable from the facts and the nature of the rights involved in the *Logan, Smith, Carter, Bradford* and *Lentz* cases, the Tax Court nevertheless distinguished *Smith* and *Carter* in the following language:[18]

> "In *Westover v. Smith, supra,* and *Commissioner v. Carter, supra,* the facts were that contractual rights received upon the dissolution of the corporation had no ascertainable fair market value. Here the facts are otherwise. See Pat O'Brien, 25 T. C. 376."

The *O'Brien* case is indeed distinguishable from the *Smith* and *Carter* cases, but it is also distinguishable, for the identical reasons, from the case here involved, and the Tax Court's reliance upon it was erroneous. In the *O'Brien* case, taxpayer was a former stockholder of a corporation which produced a motion picture photoplay which was financed by Columbia Pictures Corporation.

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[18]Opinion, R. p. 84.

The producer, of course, owned the motion picture photoplay, but entered into a distribution or lease and license agreement with Columbia for the distribution and exploitation of the motion picture by Columbia. Columbia also agreed to assist in the financing of the production. Shortly after the completion of the production and the release for distribution of the motion picture, the corporation was dissolved and there was a transfer in liquidation to the stockholders, including taxpayer, of all of the corporation's right, title and interest *in the motion picture.* This transfer was subject to the rights of Columbia to lease and license the motion picture under the distribution agreement. As a result of the dissolution, taxpayer reported a capital gain measured by cash over basis for stock plus the fair market value of his proportionate interest in the motion picture. Thereafter taxpayer reported his share of the receipts from the motion picture, in excess of his basis thereof,[19] being the fair market value at the time of the dissolution, as ordinary income. The Court found that in fact the fair market value of taxpayer's right, title and interest in the motion picture was the amount reported by him in his income tax return.

Subsequently, upon respondent's determination of deficiencies for other reasons, in the litigation, taxpayer contended that the sums received by him in excess of his basis, that is the fair market value at distribution, and theretofore reported as ordinary income, should have been reported as additional capital gains. In support of this position, he relied on *Westover v. Smith* and *Susan J. Carter.*

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[19]Presumably taxpayer treated all receipts up to the fair market value as allowable depreciation.

In distinguishing those cases, the Tax Court there pointed out that the interest in the motion picture photoplay which taxpayer received had a readily ascertainable fair market value at the time of dissolution, and the distribution of the asset was a closed transaction for federal tax purposes, whereas, in the *Smith* and *Carter* cases the dissolution of the corporations was not a closed transaction for tax purposes with respect to assets which had no fair market value on the date of dissolution. What is unsaid, but obvious from the opinion, is the fact that in that case, the taxpayers at dissolution received an asset *the use and exploitation of which produced income* and it was that income which the taxpayer had reported as, and the Court held to be, ordinary income. In *O'Brien,* the income had no direct relation to the exchange but *issued from* and was produced by the *rental of the property* which taxpayer had received in the dissolution exchange. In *Smith, Carter* and the instant case, the stockholders received, in exchange for their stock in the dissolved corporation, not an asset which could be rented or otherwise exploited to produce rental or other income from its use, but the right to receive the very payments which constituted the income.

In this case, therefore, as in *Smith* and *Carter,* the question is simply whether respondent may, or for that matter, can, with any degree of accuracy, commute the payments into a principal sum of ascertainable value, which he can treat as a cash equivalent. In this case, as in *Smith* and *Carter,* the answer must be in the negative.

3. **An Analysis of the Evidentiary Findings of Fact, From Which the Tax Court Apparently Drew Its Erroneous Conclusion of Ultimate Fact, Reveals That No Distinction From Logan and Smith Exists.**

In support of its ultimate finding of fact that the water contracts here involved did have a fair market value at dissolution, the Tax Court, in its opinion, cites the following elements:[20]

(i) None of the contracts were as much as three years old at the time of distribution.

(ii) The payments under them had commenced on all except the Lawrence contract, on which they began shortly thereafter. All houses had been completed and sold by the time each corporation dissolved.

(iii) Expert witnesses testified that one might expect to receive as much as 70% of the total original payment on contracts similar to those here involved.

(iv) Expert witnesses testified that contracts similar to those here were bought and sold.

As to items (i), (ii) and (iii) all were clearly present as evidentiary facts in the *Logan, Smith* and *Carter* cases.

(i) *The Age of the Contracts.*

The only point of the finding in subparagraph (i), as to the three-year age of the contracts, can be to indicate that payments might be made thereon for a period as long as seven years.[21] However, in *Logan* there was no limitation of time whatever, a fact more favorable to the determination of value than here; nor was there an

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[20]R. pp. 83 and 84.

[21]Note that at dissolution all of the contracts had remaining less than the original ten-year term. [F. of F. Ex. 1-7.]

express limitation of time in the *Smith* case, although perhaps the limited life of the patents might have furnished such a limitation.

(ii) *The Probability That Some Payments Would Be Made.*

The only point here involved can be the fact that some payments undoubtedly would be made, and were being made and for that matter were accruing at the very time of dissolution. But that was precisely the fact in *Logan, Smith* and *Carter*. In the *Logan* case, large but varying amounts of ore, the measure of the contract payments, had been and continued to be mined prior and subsequent to the date of the sale; in the *Smith* case, machinery was being manufactured by the purchaser at the time of dissolution, as a result of which the contractual right, as the Court said, "had a very substantial value," and in the *Carter* case, the third party transactions in respect of which the commissions representing the contractual rights were to arise were pending at the time of dissolution.

(iii) *The so Called Predictable Average.*

It is obvious that in each of those cases the recipient under the contract right expected to receive substantial amounts as a result of the contract.

The Tax Court did find that *"under normal conditions,* approximately 70 per cent of the original [maximum] payment might be expected on such [similar] contracts.[22]

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[22]Emphasis added. [F. of F., R. p. 70.] This finding was the second part of a compound sentence, the first part of which referred to sales of such contracts. Since, as demonstrated later, there was no evidence whatever tying in the 70 per cent with sales, it is assumed that the finding related to the average payout by San Gabriel upon all of its contracts of this type, and not to any average or suggested sales price.

The only testimony in the record concerning the question of estimated future receipts from similar contracts is to be found in the testimony of Mr. Moseley and Mr. Garnier, who, presumably were the experts to whom the Tax Court referred. The testimony of Mr. Moseley on this subject is somewhat equivocal, but what evidence he gave on the subject is found on pages 200, 201 and 202 of the record. Without taking into account economic depressions, floods, earthquakes, droughts and less than full occupancy (none of which factors can be readily brushed aside in the Los Angeles County area) Mr. Moseley estimated that, *as an average,* it would be conservative to estimate that 70 per cent of the payments made in San Gabriel in respect of all their contracts, might be expected to be refunded. He made it clear, however, that even ignoring the factors above mentioned, "some would pay off *much less* than seventy per cent." (Emphasis added.) He did not testify as to whether he considered the particular contracts here involved were below, equal to or above the average.[23] Mr. Garnier testified in the same vein, emphasizing that he was speaking of an average, and substantially agreed with Mr. Moseley.[24]

In the face of the foregoing evidence, it is difficult to see how the Tax Court is justified in inferring from the existence of an average estimated payment (without regard to factors unfavorable to payment under the contracts) computed on the basis of hundreds of contracts,

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[23]For convenience, Mr. Moseley's entire testimony on this subject is reproduced in the Appendix, pp. 9 and 10.

[24][R. pp. 237 and 238.] For convenience, Mr. Garnier's entire testimony on this subject is reproduced in the Appendix, pp. 6, 7, 8 and 9.

the conditions of and the factors concerning which are not in the record, that the contracts here involved, *even subject to the proviso that in the future normal conditions prevail,* may reasonably be expected to pay 70 per cent of their respective maximums. Such an inference necessarily requires too many intermediate assumptions, and the finding must fall. Such an inference is as unsound as one which concludes that the price of any given stock listed on the New York Stock Exchange is the average of the prices of all of the stocks listed on that exchange.

But assuming, *arguendo,* that the finding "under normal conditions, approximately 70 per cent of the original payments might be expected on such [similar] contracts" is properly inferred, the additional inference required to be made by the Tax Court to find, as an ultimate fact, that the contract rights here involved have an ascertainable fair market value, runs afoul of the principles enunciated in the *Logan, Smith, Carter, Bradford* and *Lentz* cases. If those cases stand for anything, they stand for the proposition that for the purpose of determining a taxpayer's income in any given year, for income tax purposes, it is unnecessary, at sale or dissolution, to assume or determine what conditions, normal or abnormal, will obtain in future years, insofar as third persons, not legally bound, are concerned. It was the Supreme Court's refusal to assume that the future mining of ore might or should be measured by the past actions of third persons which led to its conclusion that there be no commutation of estimated future receipts; it was this Court's refusal, in the *Smith* case, because of future business contingencies, to assume that future sales of patented machinery might or should be measured by past sales, which lead to a similar conclusion that there be no commutation of future

receipts. In the face of the unpredictable variables from normal conditions, as found by the Tax Court itself,[25] it is submitted that the Tax Court's finding of ultimate fact that the contract rights here involved had, on dissolution, an ascertainable fair market value, is an erroneous disregard of the rule laid down by the Supreme Court in the *Logan* case, by this Court in the *Smith* case, and by the Tax Court itself in the *Bradford* and *Lentz* cases.

(iv) *The Alleged Buying and Selling of Similar Contracts.*

As indicated above, the Tax Court made a further finding of evidentiary fact that "similar contracts to those here in issue were bought and sold."[26] If this finding is intended to mean no more than the fact that at some time or times between 1937 and April 29, 1955, there were sales of six similar contracts, one at least taking place after April, 1953,[27] and in respect of which the terms of sale were unknown as to five, and as to

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[25][*Cf.* F. of F., R. p. 70.] Such as weather conditions involving excessive rainfall, economic recession induced decrease of plantings for irrigation and economic recession induced decrease of acquisition of water consuming appliances.

[26][F. of F., R. p. 70.] Although as part of the same sentence, the opinion continued with the expression "and, under normal conditions, approximately 70 percent of the original payment might be expected on such contracts", petitioners assume, because there is no evidence whatever to support a contrary assumption, that the Tax Court did not find or intend to find that such sales, as distinguished from payments from the contracting water company, might be expected to produce "approximately 70 per cent of the original payment", that is, the maximum amount payable under such contract. The evidence, referred to above, concerning the "70 per cent average" had no reference to sales. Moreover, the telescoping in one sentence of the two separate matters seems apparent by the use of the words "original payment", since obviously, any sale which might take place after there was less than 70 per cent unpaid could not hope to call for a premium price, in the face of future contingencies and the absence of interest.

[27][R. p. 231.]

the sixth the price was $840 for a contract having a maximum balance of $6,800, then petitioners do not dispute the accuracy of such evidentiary finding.

Petitioners insist that such evidentiary finding must be so limited, however, because in the entire record, the only evidence of sales of contracts of this type is to be found in the testimony of the witnesses Moseley and Garnier, who are presumably the experts to whom the Tax Court is referring. Mr. Moseley's entire testimony on the subject of sales discloses that he knew of four sales, in all, which he could not pin down as to time, with reference to the year 1950, or at all.[28] As a supplement to the foregoing evidence, petitioners refer to the fact that they and respondent stipulated[29] that on July 1, 1950, San Gabriel had outstanding 277 water facilities contracts of the type here involved. The record also discloses[30] that Mr. Moseley had been employed with San Gabriel from 1937 to beyond the date of the hearing.

Mr. Garnier's testimony on the subject of sales disclosed that he and his sister jointly had purchased one such similar contract, four years after the tract to which it applied had been fully occupied, for approximately 13 per cent of its then face amount, and that his construction company had purchased, not earlier than April, 1953, one other such similar contract.[31] The time of the first sale, with reference to the dates here in-

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[28][R. pp. 187 and 188.] For convenience, Mr. Moseley's entire testimony on this subject is reproduced in the Appendix.

[29][F. of F., Supp. Stip., R. p. 122.]

[30][R. p. 177.]

[31][R. pp. 227-231.] For convenience, this portion of Mr. Garnier's testimony is reproduced in the Appendix.

volved, was not pinpointed. The terms of the second sale were not furnished. Mr. Garnier did not testify concerning any other sale, whether or not he was directly or indirectly involved, and there is nothing in the record to suggest that he was aware of the existence of any other sale.

The evidence, then, at best, indicates that there were six specific sales out of several hundred of similar contracts, at unknown prices, except as to the 13 per cent sale, with times of sale unknown, except as to one later than April, 1953, more than two years after the last pertinent date here involved, and with all other terms of sale unknown.

If, therefore, the Court's phraseology respecting the finding that "similar contracts . . . were bought and sold" is intended to indicate that a market existed in which buyers bought and sellers sold similar contracts with reasonable regularity or continuity and, the Tax Court has found the existence of a market by drawing an inference from the fact of the six isolated sales of uncertain date, price and times, petitioners do dispute such a finding as being unsupported by the record and the evidentiary facts found. Such an inference would stretch the imagination beyond credulity, particularly in the light of the language of the *Logan* opinion, which demonstrates the undesirability of indulging in mere "estimates, assumptions and speculation."[32]

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[32]283 U. S. 404, at page 412.

4. The Evidentiary Facts and Findings Did Not Justify Intermediate Inferences and the Inference of Ultimate Facts Made by the Tax Court.

None of the foregoing evidentiary facts nor all of them together were sufficient to justify an inference that the contractual rights had an *ascertainable* as distinguished from an *unascertainable,* fair market value. On the contrary, because payments depended upon transactions over which the holders of the contract rights had no control, it followed, in the words of the Court of Appeals in the *Smith* case, that "there was, owing to future business contingencies, no way of ascertaining its [the contract's] fair market value." In the instant case, as in the *Smith* case, there were unpredictable contingencies or factors which would affect the future use of water by the consumers, which in turn would affect the payments to be made by San Gabriel pursuant to the contracts. Among the factors found by the Tax Court [F. of F., R. p. 70] which would thus affect, in any year of the term of the contract, the use of water were (a) weather conditions (b) the amount of plantings and vegetation requiring irrigation and (c) the number of water consuming appliances owned by the occupants. Implied in the finding is the continued full occupancy during the remaining life of the contracts. The evidentiary findings, embraced by the stipulation, even for the short period from the date of complete occupancy to the date of the stipulation, demonstrate substantial variations from season to season and from year to year. One of such examples demonstrates that in the case of the J. Richard Co. Tract number 15062-14954, San Gabriel's average monthly payment was $92.59 for the year 1952, whereas the monthly average payment for the year 1954 in respect of the same

tract and the same contracts amounted to $214.69.[33] Perhaps it rained more in 1952 than it did in 1954, but if it did, petitioners suggest that they could hardly have evaluated such differential in the preparation of their 1950 income tax returns.

That the Tax Court has drawn the inference from six isolated sales to the existence of a market, and from the foregoing to the ultimate fact of existence of fair market value, is no bar to reversal. In situations where the ultimate fact is found by drawing inferences from evidentiary facts found by the Tax Court, it is well settled that because the reviewing Court is in as good a position to draw its own inferences or conclusions as is the trial court, that the Courts of Appeal will feel free to do so. (*Kuhn v. Princess Lida of Thurn & Taxis,* 119 F. 2d 704 (C. C. A. 3, 1941); *Murray v. Noblesville Milling Co.,* 131 F. 2d 470 (C. C. A. 7, 1942), cert. den. 318 U. S. 775, 87 L. Ed. 1145 (1943).) For further authority in support of this principle see *Adams County v. Northern Pacific Railway Co.,* 115 F. 2d 768 (C. C. A. 9, 1940), where this court applied the same rule to findings of a special master and *Stubbs v. Fulton National Bank of Atlanta,* 146 F. 2d 558 (C. C. A. 5, 1945), cert. den. 325 U. S. 864, 89 L. Ed. 1984 (1946).

Moreover, the reviewing Court may draw its own inference of ultimate fact without regard to whether or not there is support in the record for the inference drawn by the Tax Court. That such was the intention of Congress in enacting the amendment to Section 1141(a) of the Internal Revenue Code of 1939 (now Sec. 7482) is apparent from the committee report relating to this amend-

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[33][F. of F., Stip. Pars. 7 and 8, R. pp. 106-108.]

ment. There the Senate Committee on the Judiciary stated that the language used in the house bill and adopted by the Senate had the effect of repealing the rule laid down in *Dobson v. Commissioner of Internal Revenue,* 320 U. S. 489 (1943), "to the effect that decisions of the Tax Court on questions of fact, including questions of accounting and ultimate conclusions of fact, are not reviewable if supported by any evidence in the record." (Sen. Comm. on Jud., 80th Cong., 2d Sess. Report No. 1559, p. 131.) There we see the Senate Judiciary Committee drawing the distinction laid down in the *Kuhn* case, *supra,* as to questions of primary fact and ultimate conclusions of fact. Their very reference to that distinction makes it clear that it was the Congressional intent in enacting Section 1141(a) of the Internal Revenue Code to do away with the many times unfair result reached by applying the mandate of the *Dobson* case, particularly as such mandate related to review of ultimate conclusions of fact and inferences drawn from findings of evidentiary fact. It was the intention of Congress that Courts of Appeal sitting in review of decisions of the Tax Court of the United States should be free to reverse decisions of the Tax Court on question of ultimate fact and inference drawn from primary facts without reference to whether or not the conclusion of the Tax Court had support in the record.

Conclusion.

Only one reasonable conclusion can be reached from the facts which exist with respect to this issue—that the contract rights had no ascertainable fair market value and accordingly, petitioners were not required to include in their income for 1950, any amount attributable to the value of the contract rights.

B. Assuming Arguendo, an Ascertainable Fair Market Value, Petitioners, Being on the Cash Basis, Need Report Receipts Under Contracts Only in the Year of Receipt.

Even apart from the question of ability to ascertain the fair market value of the water contact rights at dissolution, petitioners contend that under the well established concept of annual accounting for income tax purposes, they need report only in the year of receipt, moneys payable to them by San Gabriel, subsequent to dissolution.

In this connection, petitioners rely upon the cases of *Kasper v. Banek,* 214 F. 2d 125 (C. A. 8th, 1954); and *Amend v. Commissioner of Internal Revenue,* 13 T. C. 178 (1949), and respondent's Revenue Ruling 58-162, I. R. B. 1958-15, 12. The facts in both of the cases, and set forth in the ruling, are substantially identical. In each case, a farmer using the cash receipts method of accounting, entered into a bona fide arms length contract of sale of his grain, calling for payment in the taxable year following that in which he delivered the grain to the purchaser pursuant to the contract. In each instance, it was held that the farmer was required to include the payment received by him from the seller in the year of receipt, and not in the year of sale.

While it is true that those cases related to a transaction involving a direct sale, in which the promise of the purchaser was treated other than a cash equivalent, petitioners submit that there is no real distinction between their position, as assignees of the dissolved corporations, and the corporations, which would be in the position analogous to that of the selling farmers. For this proposition, petitioners rely upon the rationale of *Westover v. Smith, supra.* In that case, as indicated above, the gov-

ernment sought to make the same distinction as between the taxpayer in *Burnet v. Logan, supra,* and the taxpayer in the *Smith* case, suggesting that the rule was different as between a direct seller and a recipient stockholder in a corporate distribution. As pointed out above, the attempted distinction was rejected by the court. Accordingly, if the recipient stockholder in a corporate distribution is in the same position as is the seller in the case of a direct sale, it follows that the stockholders here involved are in the same position as the taxpayers referred to in the *Banek* and *Amend* cases and the above cited Revenue Ruling.

On this alternative ground, therefore, petitioners are entitled to a reversal, on this issue, of the judgment of the Tax Court.

ISSUE II.

Was Petitioner Albert Gersten Entitled to File a Joint Return for the Taxable Year 1950 With His Wife, Bernice Ann Gersten.

1. Introductory.

Under Section 51(b) of the Internal Revenue Code of 1939,[34] husband and wife were permitted to file a single income tax return jointly. Petitioner Albert Gersten (sometimes herein called "Albert") and Bernice Ann Gersten (sometimes herein called "Bernice") so elected for the year 1950, but respondent determined that they were not legally married and accordingly treated the return as that solely of Albert.

The issue here involved, and the sole question to be determined, is whether, under the facts as here found,

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[34]Appendix, pp. 2 and 3.

Albert and Bernice were "husband and wife" within the meaning of those words as used by Congress in adding Section 51(b) to the Internal Revenue Code of 1939, in its enactment of The Revenue Act of 1948. The legislative history of that enactment demonstrates that it was intended to secure, for all married persons, whether or not they lived in the so-called community property states, equivalent income tax benefits which flowed from the existence of the community property laws.[35] It is submitted that in its use of the term, Congress did not intend to limit the phrase "husband and wife" to spouses whose status had the greatest degree of validity under local law, but intended it also to apply to two persons whose relationship to each other was of such a status, under local law, that had they been domiciliaries of a community property state, they would each own one half of the community income and thereby be entitled to avail themselves, for income tax purposes, of a division of that income in separate income tax returns, under the rule of *Poe v. Seaborn,* 282 U. S. 101.

2. Petitioner Concedes That the Question of Marriage and Divorce Is Determined by State Law; but Under California Law, so Far as Petitioner and Bernice Are Concerned, They Are Husband and Wife.

The trial court, in affirming the determination of respondent, insisted that for this purpose, "marriage, its existence and dissolution, is particularly within the province of the states," citing *Marriner S. Eccles,* 19 T. C. 1049, aff'd 208 F. 2d 796 and *Commissioner v. Ostler,* 237 F. 2d 501. With this conclusion, petitioner agrees; but it does not follow that only those husbands and wives

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[35]House Committee Rep., 1948 Revenue Act, C. B. 1948-1, p. 301.

whose marriages, under state law, involve no irregularities whatever, are "husband and wife" within Section 51(b). Parties to a voidable marriage are not the less husband and wife,[36] nor are parties to an irregular foreign marriage, where one or both are estopped from asserting the irregularity.[37]

The case of *Spellens v. Spellens, supra,* decided by the California Supreme Court on October 30, 1957,[38] seems determinative of this issue. In that case, plaintiff wife sued her husband for a decree of permanent support and maintenance.[39] Plaintiff had been previously married to one Seymon, but obtained an interlocutory decree of divorce against him on March 13, 1951. Shortly thereafter, defendant took plaintiff to Mexico, where they consulted an attorney who advised them they could be legally married in Mexico. As a result, on March 17, 1951, four days after the entry of the interlocutory decree, plaintiff and defendant were married in Mexico and began living together as husband and wife. In March, 1952, after, as the court found, defendant had been guilty

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[36]Note that under California Civil Code Section 83 (Appendix, pp. 2, 3) the ability to obtain a decree of nullity of marriage is limited as to time and parties, and in the absence of action by a proper party within the proper time, the marriage is as immune to attack as one without frailties subjecting it to risk of annulment.

[37]*Cf. Spellens v. Spellens,* 49 A. C. 213.

[38]The date of the Tax Court's order herein, but some four months after the entry of its opinion.

[39]Under Section 137 of the California Civil Code (Appendix, p. 5) it is provided that "When the husband or wife has any cause of action for divorce as provided in this code, . . . he or she, as the case may be, may, without applying for a divorce, maintain in the Superior Court an action against her or him, as the case may be, for the permanent support and maintenance of herself or himself, . . ." Obviously, in such action, the plaintiff must be a husband or wife, and the other spouse must be the defendant or one of the defendants.

of cruelty to plaintiff, defendant suggested that they separate. Plaintiff commenced her action on March 24, 1952, but after a brief separation, the parties reconciled and lived together until defendant left plaintiff in September 1952. In an amended complaint, plaintiff asked that her marriage be declared valid and that defendant be estopped to question its validity. Defendant asserted, as an affirmative defense, that the marriage was void as being after the entry of the interlocutory decree but prior to the final decree, and asked that the Mexican marriage be declared invalid. Note that there had never been a Mexican divorce.

The trial court held that the marriage was invalid and plaintiff appealed. On appeal, the California Supreme Court, relying primarily on *Watson v. Watson,* 39 Cal. 2d 305, 307, 246 P. 2d 19, and *Rediker v. Rediker,* 35 Cal. 2d 796, 805, 221 P. 2d 1, 20 A. L. R. 2d 1152, reversed and held that defendant could not contest the validity of the marriage. In its opinion, the court, at page 221, quoting its prior quotation from Rediker in the Watson opinion, reiterated:

> " '*the validity of a divorce decree cannot be contested by a party who has procured the decree or a party who has remarried in reliance thereon or by one who has aided another to procure the decree so that the latter will be free to marry.*' " (The emphasis was furnished by the court.)

With respect to the public policy of the state of California, the Court, at page 222, quoting from *Dietrich v. Dietrich,* 41 Cal. 2d 497, 505, 261 P. 2d 269, had this comment:

> " 'The *public policy* of this state, in the circumstances of this case, as in those considered in *Rediker v.*

> *Rediker* (1950), 35 Cal. 2d 796, 808 (221 P. 2d 1, 21 A. L. R. 2d 1152) *requires recognition of the second marriage* rather than the "dubious attempt to resurrect the original" marriage.'" (Emphasis added.)

and went on to cite a long line of authorities.[40] At this point, too, it stated, *"Roberts v. Roberts,* 81 Cal. App. 2d 871, 185 P. 2d 381, insofar as it is to the contrary must be deemed as *disapproved."*[41]

On the question of the public policy of California respecting irregular foreign marriages, the Spellens opinion continued its quotation from *Dietrich v. Dietrich,* at page 222 and 223, as follows:

> "'Defendant contends, however, that the public policy of the state requires the annulment of bigamous marriages whenever their bigamous character is discovered. We find no basis for such a sweeping application of public policy. . . . Defendant does not indicate how any public purpose is served by the annulment of his marriage. . . .

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[40]*Rediker v. Rediker,* 35 Cal. 2d 796, 221 P. 2d 1, 21 A. L. R. 2d 1152; *Bruguiere v. Bruguiere,* 172 Cal. 199, 155 Pac. 988, Ann. Cas. 1917, 122; *Kelsey v. Miller,* 203 Cal. 61, 263 Pac. 200; *Harlan v. Harlan,* 70 Cal. App. 2d 657, 161 P. 2d 490; *Estate of Davis,* 38 Cal. App. 2d 579, 101 P. 2d 761, 102 P. 2d 545; *Hensgen v. Silberman,* 87 Cal. App. 2d 668, 197 P. 2d 356; *In re Kyle,* 77 Cal. App. 2d 634, 176 P. 2d 96; *Adoption of D. S.,* 107 Cal. App. 2d 211, 236 P. 2d 821; *Estate of Coleman,* 132 Cal. App. 2d 137, 281 P. 2d 567; *Union Bank & Trust Co. v. Gordon,* 116 Cal. App. 2d 681, 254 P. 2d 644; *Morrow v. Morrow,* 40 Cal. App. 2d 474, 105 P. 2d 129; 175 A. L. R. 538; 153 *id.* 941; 140 *id.* 914; 122 A. L. R. 1324; 109 *id.* 1018; Rest., Conflicts, Sec. 112. Note that the Tax Court erroneously relied on *Estate of Davis, supra,* cited above, which did not support its conclusion.

[41]The Tax Court relied strongly on *Roberts v. Roberts* and *Kegley v. Kegley,* 16 Cal. App. 2d 216, 60 P. 2d 482. The *Kegley* case contained the same rationale as the Roberts opinion, which relied strongly on Kegley.

"'"It can no longer be said that public policy requires non-recognition of all irregular foreign divorces. We have recognized that the interest of the state in many situations may lie with recognition of such divorces and preservation of remarriages rather than a dubious attempt to resurrect the original. From a pragmatic viewpoint, judicial invalidation of irregular foreign divorces and attendant remarriages, years after both events, is a less than effective sanction against an institution whose charm lies in its immediate respectability. We think it may now be stated that the *general* public policy in this jurisdiction, as judicially interpreted, no longer prevents application in annulment actions of the laches and estoppel doctrines in determining the effect to be given such divorce decrees." (Vinson J., in Goodloe v. Hawk, 113 F. 2d 753, 757; Harlan v. Harlan, 70 Cal. App. 2d 657, 663-664 (161 P. 2d 490); Krause v. Krause, 282 N. Y. 355, 360 (26 N.E. 2d 290).) We conclude that the public policy of this state requires the preservation of the second marriage and the protection of the rights of the second spouse "rather than a dubious attempt to resurrect the original" marriage.' (*Rediker v. Rediker,* supra, 35 Cal. 2d 796, 806)."

The significant result of the *Spellens* decision is that because defendant was held estopped, the matter was remanded for further action requiring a determination of the amount of permanent support and maintenance to be awarded plaintiff, an award which under Section 137 of the California Civil Code could be made only against one spouse in favor of the other. Moreover, plaintiff's action for fraud in inducing the marriage was dismissed, because, as the court stated, at page 225, ". . . she, by the

estoppel, is receiving everything flowing from a valid marriage[42] and we apply the same law as if they were validly married . . ."

In the light of the *Spellens* case, there can be no doubt that neither Albert nor Bernice[43] could successfully assert against the other that they were not married. Accordingly, the only method by which either of them during their lifetime would have to change their marital status and relationship would be by way of an action for divorce.[44]

3. The Cases Primarily Relied Upon by the Tax Court in Reaching a Contrary Conclusion Have Been Overruled or Disapproved. The Other Cases Cited by It on This Point Are Distinguishable.

In reaching its conclusion, the court in the *Spellens* case, placed a gloss upon Section 61 of the California Civil Code[45] which precludes the literal rigidity with which the Tax Court read that Section, and left no doubt that as between the plaintiff and the estopped defendant, they were husband and wife. It did so, at pages 223 and 234, in the following words:

> "The foregoing authorities involved an estoppel to deny the validity of a decree invalid because of lack of jurisdiction of the court which purported to grant it *but we think the same policy requires the same result in the instant case where there was a marriage before a year after the entry of an interlocutory decree.* The policy applies equally in one

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[42]Including ownership of one half of the community income.

[43]Albert for obtaining, and Bernice for relying on and aiding in, the Mexican decree. *Cf. Spellens v. Spellens,* at page 221.

[44]Appendix, p. 5.

[45]Appendix, p. 11.

case as the other. *The policy against a bigamous marriage expressed in the first sentence of section 61 of the Civil Code, supra, involved in the cited cases, is no stronger nor more compelling than that involved here which is that there may not be a valid marriage if contracted within less than a year after the entry of an interlocutory decree of divorce. (Civ. Code, Section 61, subd. 1, supra.) We fail to see any difference in this case and one where defendant had participated in the obtaining of an invalid Nevada or Mexican divorce rather than a California interlocutory decree.* It is not the marriage which is found valid as indicated by the above authorities and thus the policy of Section 61, subdivision 1, is not thwarted. Rather it is that defendant by reason of his conduct will not be permitted to question its validity or the divorce; *so far as he is concerned, he and plaintiff are husband and wife."* (Emphasis added.)

In support of its acceptance of what it referred to as the "express" provisions of Section 61 of the Civil Code, the Tax Court cited five cases as follows: *People v. Little,* 41 Cal. App. 2d 797, 107 P. 2d 634; *In re Elliott's Estate,* 165 Cal. 339, 132 Pac. 439; *In re Gregorson's Estate,* 160 Cal. 21, 116 Pac. 60; *Parmann v. Parmann,* 56 Cal. App. 2d 797, 107 P. 2d 634; *Vickers v. State Bar of California,* 32 Cal. App. 2d 247, 196 P. 2d 10. Of these, *Elliott* and *Parmann* were distinguished by the *Spellens* case as not discussing estoppel, the court there stating, at page 224, "insofar as they may be deemed contrary . . . they are overruled." *Estate of Gregorson* involved no divorce decree, valid or invalid, interlocutory or final, but simply related to the competency of an alleged incompetent to marry. *Vickers v. State Bar* similarly involved no decree, interlocutory, foreign or otherwise,

but simply a belief that divorce proceedings had been initiated, and as such is distinguishable. *People v. Little* may be indistinguishable, but is an earlier opinion, and of a lower court, and to the extent it cannot be distinguished, must also be deemed disapproved, and not to be followed in the face of *Spellens, Watson* and *Rediker*.

4. Administrative Requirements Preclude a Concept of a Marital Status for Tax Purposes Different From the Marital Status Under Local Law; and the Commissioner of Internal Revenue, by Concurrent Executive Interpretation of a Statute in Pari Materia to Section 51(b) of the Internal Revenue Code of 1939, has so Determined.

It would be incongruous indeed, if the Commissioner of Internal Revenue were permitted to cast aside this marriage relationship without cause given by either spouse when the California courts could not do so in the absence of proof, properly corroborated, of one of the seven grounds for divorce provided for in Section 92 of the California Civil Code (Appx. p. 5). Moreover, such action by the respondent would result in an administrative nightmare. If, for income tax purposes, respondent may reject Bernice as Albert's wife, he may not then reject Lucille, the former wife whom the respondent persists in recognizing as the true and only wife, and may not, therefore bar Albert and Lucille from filing a single joint income tax return for the year 1950, or for any subsequent year if Albert and Lucille do not cause a final decree to be entered. (*Cf., Marriner S. Eccles,* 19 T. C. 1049, affd. 208 F. 2d 796.)[46] However, under the *Spel-*

[46]It was the *Eccles* case upon which the Tax Court grounded its opinion as to the recognition of local state law relating to marital status.

lens decision, the community property earned by Albert after his Mexican marriage to Bernice belongs one half to Albert, and one half to Bernice. If respondent and the trial court are correct, it would follow therefore, that Albert and Lucille may file a single joint income tax return, including therein, however, but one half of Albert's community earnings[47] and Bernice is required to file a separate income tax return, reporting the remaining one half of Albert's community earnings. (*Marjorie Hunt,* 22 T. C. 228 (1954).) It is highly unlikely that Congress intended such a result by its enactment of Section 51(b) of the Internal Revenue Code of 1939.

A sounder, as well as more realistic view, is that adopted by respondent in General Counsel Memorandum 25250, Cumulative Bulletin 1947-2, page 32, promulgated within a year before Congress had before it the matter of husband and wife in relation to the joint return. The editor's summary of that memorandum opinion is as follows:

> "The taxpayer and his wife, who were domiciled in the State of Connecticut, entered into a separation agreement in January, 1935, which provided for monthly payments to her. She obtained a decree of divorce from a court in Mexico within two weeks thereafter, and the husband then remarried. Payments were made under the 1935 agreement until July of 1943, at which time the wife was advised by counsel that the Mexican divorce would not be recognized by the courts of Connecticut. Under a new agreement which made no mention of the Mexi-

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[47]Under *Poe v. Seaborn,* 282 U. S. 101, and *United States v. Malcolm,* 282 U. S. 292, Albert includes only that part of his community earnings which he owns, which, under Spellens and California Civil Code Section 161a (Appendix, p. 6) is one half.

can divorce, a lump-sum settlement was made, and the wife thereafter obtained a divorce from a court in Nevada. *Held,* the monthly payments made in 1942 and 1943 are deductible under Section 23(u) of the Internal Revenue Code."

In the course of the opinion it is said, at page 33:

"Although some State courts refuse to recognize Mexican divorce decrees, it is unlikely[48] that they would permit parties to deny the validity thereof if the parties have taken steps which indicate their reliance upon the validity of such decrees."

The opinion further pointed out that the requirement that payments be made pursuant to a separation agreement incident to a divorce or decree of separate maintenance stemmed from

"the apprehension that unless the payments were part of or incident to some publicly recorded action of a court, separation agreements might be used for tax avoidance. Even though a husband and wife might execute a separation agreement as an income-splitting device, it is doubtful that a husband and wife would go through the form of a Mexican divorce for such purpose."

By the same token, it is suggested that Congress intended to make the joint return between husband and wife available, without regard to the niceties of local law.

That Section 51(b) of the Internal Revenue Code of 1939 is *in pari materia* with Sections 22(k) and 23(u) thereof, referred to in General Counsel Memorandum

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[48]In view of the *Spellens* decision, this likelihood becomes a certainty, as to California.

25250 is evident from *Commissioner of Internal Revenue v. Ostler,* 237 F. 2d 501 (C. A. 9, 1956), and Revenue Ruling 57-368, I. R. B. 1957-32, 23. In the *Ostler* case, this Court adverted to Section 51(b)5(B) of the Internal Revenue Code of 1939[49] which barred a joint return where husband and wife were legally separated under a decree, and determined, for the sake of uniformity in the light of prior decisions, that an interlocutory decree of divorce in California did not bar the filing of a joint return under Section 51(b)(1). On the basis of the *Ostler* decision, the Internal Revenue Service issued Revenue Ruling 57-368, and revoking prior inconsistent ruling, determined that if a California interlocutory decree was not a decree of legal separation barring the parties thereto from the filing of a joint return under Section 51(b)(1), it was likewise not a decree enabling a husband to deduct alimony paid pursuant thereto, under Section 23(u) of the Internal Revenue Code of 1939. General Counsel Memorandum 25250, of course, dealt with, and interpreted the nature of the decree referred to (by reference to Section 22(k) of the Internal Revenue Code of 1939) in said Section 23(u).

Here, in view of the *Spellens, Watson* and *Rediker* cases, there can be considerably less doubts as to marital status of Albert and Bernice, than existed under the facts and local law stated in the General Counsel's Memorandum. Yet the decree there was deemed a sufficient decree for income tax purposes because it was highly unlikely that the decree was intended as an income tax sham. It might be said with equal fervor in this case that it is highly unlikely that Albert or Bernice (who

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[49]Appendix, pp. 2 and 3.

relied upon the Mexican decree) entered into the state of matrimony for the purpose of obtaining the right to file a joint income tax return.

In view of the foregoing, it is submitted that the opinion and the decision of the Tax Court on this issue is erroneous and should be reversed.

Respectfully submitted,

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APPENDIX.

INTERNAL REVENUE CODE OF 1939

Sec. 22. GROSS INCOME

* * *

(k) Alimony, etc., Income.—In the case of a wife who is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, periodic payments (whether or not made at regular intervals) received subsequent to such decree in charge of, or attributable to property transferred (in trust or otherwise) in discharge of, a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by such husband under such decree or under a written instrument incident to such divorce or separation shall be includible in the gross income of such wife, and such amounts received as are attributable to property so transferred shall not be includible in the gross income of such husband. This subsection shall not apply to that part of any such periodic payment which the terms of the decree or written instrument fix, in terms of an amount of money or a portion of the payment, as a sum which is payable for the support of minor children of such husband. In case any such periodic payment is less than the amount specified in the decree or written instrument, for the purpose of applying the preceding sentence, such payment, to the extent of such sum payable for such support, shall be considered a payment for such support. Installment payments discharging a part of an obligation the principal sum of which is, in terms of money or property, specified in the decree or instrument shall not be considered period payments for the purposes of this subsection; except that an installment payment shall be considered a periodic payment for the purposes of this subsection if such principal sum, by the terms of the decree or instrument, may be or is to be paid

within a period ending more than 10 years from the date of such decree or instrument, but only to the extent that such installment payment for the taxable year of the wife (or if more than one such installment payment for such taxable year is received during such taxable year, the aggregate of such installment payments) does not exceed 10 per centum of such principal sum. For the purposes of the preceding sentence, the portion of a payment of the principal sum which is allocable to a period after the taxable year of the wife in which it is received shall be considered an installment payment for the taxable year in which it is received.

INTERNAL REVENUE CODE OF 1939

Sec. 23. DEDUCTIONS FROM GROSS INCOME

* * *

(u) Alimony, etc., Payments.—In the case of a husband described in section 22(k), amounts includible under section 22(k) in the gross income of his wife, payment of which is made within the husband's taxable year. If the amount of any such payment is, under section 22(k) or section 171, stated to be not includible in such husband's gross income, no deduction shall be allowed with respect to such payment under this subsection.

INTERNAL REVENUE CODE OF 1939

Sec. 51. INDIVIDUAL RETURNS

(a) * * *

(b) Husband and Wife.—

(1) In General.—A husband and wife may make a single return jointly. Such a return may be made even though one of the spouses has neither gross income nor deductions. If a joint return is made the tax shall be

computed on the aggregate income and the liability with respect to the tax shall be joint and several.

* * *

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* * *

(5) Determination of Status.—For the purpose of this section.—

* * *

(B) An individual who is legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married.

INTERNAL REVENUE CODE OF 1939

Sec. 1141. COURTS OF REVIEW

(a) JURISDICTION.—The courts of appeals shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in Section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in Section 1254 of Title 28 of the United States Code.

INTERNAL REVENUE CODE OF 1954

Sec. 7482. COURTS OF REVIEW

(a) Jurisdiction.—The United States Courts of Appeals shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts

in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 1254 of Title 28 of the United States Code.

CIVIL CODE OF CALIFORNIA

Section 83. (WHEN AND BY WHOM ACTIONS MUST BE COMMENCED.)

An action to obtain a decree of nullity of marriage, for causes mentioned in the preceding section, must be commenced within the periods and by the parties, as follows:

One. For causes mentioned in subdivision one: by the party to the marriage who was married under the age of legal consent, within four years after arriving at the age of consent; or by a parent, guardian, or other person having charge of such nonaged male or female, at any time before such married minor has arrived at the age of legal consent.

Two. For causes mentioned in subdivision two: by either party during the life of the other, or by such former husband or wife.

Three. For causes mentioned in subdivision three: by the party injured, or relative or guardian of the party of unsound mind, at any time before the death of either party.

Four. For causes mentioned in subdivision four: by the party injured, within four years after the discovery of the facts constituting the fraud.

Five. For causes mentioned in subdivision five: by the injured party, within four years after the marriage.

Six. For causes mentioned in subdivision six: by the injured party, within four years after the marriage. (Enacted 1872; Am. Code Amdts. 1873-74, p. 188.)

CIVIL CODE OF CALIFORNIA

Section 90. (MARRIAGE, HOW DISSOLVED.)
Marriage is dissolved only:

One—by the death of one of the parties; or,

Two—By the judgment of a court of competent jurisdiction decreeing a divorce of the parties. (Enacted 1872; Am. Code Amdts. 1873-74, p. 189.)

Section 92. (GROUNDS FOR DIVORCE.) Divorces may be granted for any of the following causes:

One. Adultery.
Two. Extreme cruelty.
Three. Wilful desertion.
Four. Wilful neglect.
Five. Habitual intemperance.
Six. Conviction of a felony.
Seven. Incurable insanity.

CIVIL CODE OF CALIFORNIA

Section 137. (ACTION FOR PERMANENT SUPPORT AND MAINTENANCE WITHOUT APPLYING FOR DIVORCE.) When the husband or wife has any cause of action for divorce as provided in this code, or the husband or wife wilfully deserts the wife or husband, or when the husband or wife wilfully fails to provide for the wife or husband, he or she, as the case may be, may, without applying for a divorce, maintain in the superior court an action against her or him, as the case may be, for the permanent support and maintenance of herself or himself, and may include therein at her or his discretion an action for support, maintenance and education of the children of said marriage during their minority. Such action shall be known as an action for separate maintenance.

Section 161a. (Interests in Community Property.) The respective interests of the husband and wife in community property during continuance of the marriage relation are present, existing and equal interests under the management and control of the husband as is provided in sections 172 and 172a of the Civil Code. This section shall be construed as defining the respective interests and rights of husband and wife in the community property.

Excerpts From Testimony of Camille A. Garnier

[R. pp. 227, 229, 230, 231, 237, 238]

[R. p. 227]:

Q. (By Mr. Constable): Have you ever personally bought one of these contracts? A. Yes, sir.

* * *

[R. p. 229]:

Q. I think you testified that you could not predict the amount of refunds to be obtained on a water deposit contract? A. Yes sir. It is very difficult to predict it with any certainty.

Q. But it can be predicted? A. Yes, within bounds, yes, sir.

Q. And on the basis of that *prediction,* you bought some contracts? A. I *bought a contract.*

Q. *A* contract? A. Yes, sir.

* * *

Q. (By Mr. Shearer): Did you buy that contract personally? A. Yes, sir.

Q. Was the subdivision to which it related fully completed when you bought it? A. Well, the houses had been installed and fully occupied for a period of about four years.

Q. Where was this property? A. West Covina.

Q. How much did you pay for that contract? A. I think we paid about $8,400[50] [sic.] for a $6,800 contract.

* * *

[R. p. 230]:

Q. (By Mr. Constable): Mr. Garnier, you have purchased contracts or a contract, you say, personally; then you said "we". Now, whom were you referring to? A. Well, I am speaking for my sister and myself, who is in business with me.

Q. Now, Mr. Garnier, in addition to purchasing some of these contracts personally, you have, have you not, through companies in which you have a financial interest purchased some of these similar contracts?

Mr. Shearer: Again I am going to object on the ground that this is improper cross examination.

The Court: The objection is overruled.

The Witness: Would you repeat the question?

(Question read.) A. Yes.

Mr. Constable: That is all, your Honor.

Mr. Shearer: I would like to examine further on the new matter raised by counsel.

The Court: Well, I don't know whether there is any new matter that has been raised, but if you have some questions, you may ask because he is your witness:

[R. p. 231]:

Q. (By Mr. Shearer): What companies purchased these contracts? A. Well, it is a little difficult to answer that question so that it would be properly interpreted. It would be necessary for me to make a statement prior to that, if that is agreeable, because the purchase of the con-

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[50]The actual testimony was $840, but the reporter's transcript erroneously transcribed it at $8400. A request by petitioners for a stipulation to correct the record is pending and failing that a motion so to do will be brought.

tract within our company, which has been very limited, is for a purpose—not a basis—utterly different than was ever available to Mr. Gersten.

Mr. Constable: I object. I move that this be stricken.

The Court: Well, I think if you can answer the question, then if there is any explanation called for, why, it may be asked.

(Question read.)

The Court: Let the record show that he is asking what company.

A. I think Garnier Construction Company purchased a contract.

Q. That is in addition to the contract to which you referred when you spoke of a purchase by yourself and your sister? A. That is correct.

Q. Now, when did Garnier Construction Company purchase this contract? A. I wouldn't know. It would be in the *last two years probably.*

* * *

[R. pp. 237, 238]:

By The Court: In other words, where that exists, your experience would be that—your study—they had gotten back in the period 25 percent? A. Of the full deposit by the end of the tenth year.

Q. All right. Now, contrast that situation with one that is fully built and sales are what might be regarded as normal, namely, the sales of the houses to purchasers. A. In the case of a subdivider that is going to build the houses at the same time that the mains are installed, the amount of money that would be returned of the total deposit would depend a great deal on the time that that installation was made, and as an average—again I am speaking as an average over let's say 10,000 services have been installed by our company in the last two or three

years, which may not be applicable to this case, which was way prior, and where costs were different and everything else—the refund will be anywhere from 65 percent to about 105, with an average of about 70 to 80, approximately very close with what Mr. Moseley said.

EXCERPTS FROM TESTIMONY OF M. E. MOSELEY [R. pp. 187, 188, 200, 201 and 202]:

[R. p. 187]:

Q. (By Mr. Shearer): Mr. Moseley, speaking of a period of time after June, 1949, and not later than December 31, 1950, do you know of any sales of rights to receive refunds under contracts similar to Exhibits 1 through 7 which were issued by your company? A. I know of some sales, *but I can't pin them down as to the time* at this moment.

Q. Do you know approximately how many sales were made, that is, that you know of? A. I know of, I believe, *four contracts that have been sold.*

Q. Now, did those relate to subdivisions which had been completely occupied, that is, were completed as far as subdivision was concerned?

The Court: Which do you mean, occupied or completed?

Q. (By Mr. Shearer): Did those refer to subdivisions in respect of which the homes had been completely or substantially completely built? A. *Three of them* were substantially or completely built and one was not.

Q. Can you tell us approximately how many such contracts were then existing *in that period to which I have referred?* A. I don't know that these were sold during that period. *They may have been sold more recently than that.*

Q. My question was directed to the period. A. I told you that I knew of the sale of four contracts, but I couldn't tell you *as to the time,* whether they were sold during that period or not; I can't tell.

* * *

[R. p. 200]:

Q. (By Mr. Constable): Now, thinking back to, oh, during the period 1949 to 1950, barring the possibilities of depressions and floods and earthquakes and droughts, and ignoring the occupancy question, isn't it a conservative estimate to say that at least 70 percent of the refunds will be made on the contracts which San Gabriel Water Company has with subdividers?

[R. p. 201]:

* * *

Mr. Constable: I believe I said, "Is it not a conservative estimate that 70 percent of the refunds would be made under the contracts which San Gabriel had with its builders?" A. I believe it would be.

* * *

Q. (By Mr. Shearer): Mr. Moseley, is your 70 percent an average figure? A. No. Oh, I beg your pardon.

Q. The 70 percent answer you gave to the last question, are you giving that as an average figure? A. That would be what it would amount to, I'd say.

Q. Do you believe that there will be some which will pay off less than 70 percent? A. You mean at this time or in 1950?

Q. Speaking as of 1950, with respect to the contract you then had, and having in mind the various factors you took into account— A. Yes, some would pay off much less than 70 percent.

[R. p. 202]:

Q. *Some would pay off at more than 70 percent?*
A. *Yes, sir.* (Emphasis added.)

CIVIL CODE OF CALIFORNIA

Section 61. (SUBSEQUENT MARRIAGES VOID: EXCEPTIONS: INTERVAL FOLLOWING DIVORCE: MARRIAGE VALID UNTIL ANNULLED WHERE FORMER SPOUSE ABSENT.)

A subsequent marriage contracted by any person during the life of a former husband or wife of such person, with any person other than such former husband or wife, is illegal and void from the beginning, unless:

1. The former marriage has been annulled or dissolved. In no case can a marriage of either of the parties during the life of the other, be valid in this state, if contracted within one year after the entry of an interlocutory decree in a proceeding for divorce.

2. Unless such former husband or wife is absent, and not known to such person to be living for the space of five successive years immediately preceding such subsequent marriage, or is generally reputed or believed by such person to be dead at the time such subsequent marriage was contracted. In either of which cases the subsequent marriage is valid until its nullity is adjudged by a competent tribunal.